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Situation and Financing Capacity of the Hungarian Insurance Market*

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The article presents the size of the insurance sector and looks at recent developments and regulatory changes. It briefly describes the impacts of the 2020 coronavirus pandemic on the insurance sector, while also outlining further growth opportunities for the future, in line with a previous publication by the Magyar Nemzeti Bank (the Central Bank of Hungary, MNB). It also highlights the potential of insurance investments to finance public debt and the economy.

1. Introduction

The primary purpose of insurance is to prepare against risk events in everyday life in a risk community with other customers. The related financial products are mainly contracted at the individual level and can therefore be seen as an important form of self-reliance. Claim and service payments mitigate the losses suffered and, in the case of life insurance for savings purposes, contribute to the redistribution of lifetime income.

Payments following insurance events stabilise the evolution of the economy at the individual level, making its operation more predictable. The relative size of the sector may go hand in hand with its stabilising effect, and thus higher insurance penetration may increase the positive impact of the insurance market on the economy as a whole. The importance of the sector is enhanced by the fact that small, regular payments are made into life insurance for savings purposes, mainly from households, and most of these payments do not divert resources from other investment vehicles, thus increasing the savings rate. The customer wealth thus accumulated can function as a source of additional financing for both the public and private sectors.

2. Size of the insurance market

One measure of the economic importance of the Hungarian insurance market is the ratio of the sector's revenue to gross domestic product (GDP), i.e. its penetration. The gross premiums of insurance joint stock companies and large insurance

* The papers in this issue contain the views of the authors which are not necessarily the same as the official views of the Magyar Nemzeti Bank.

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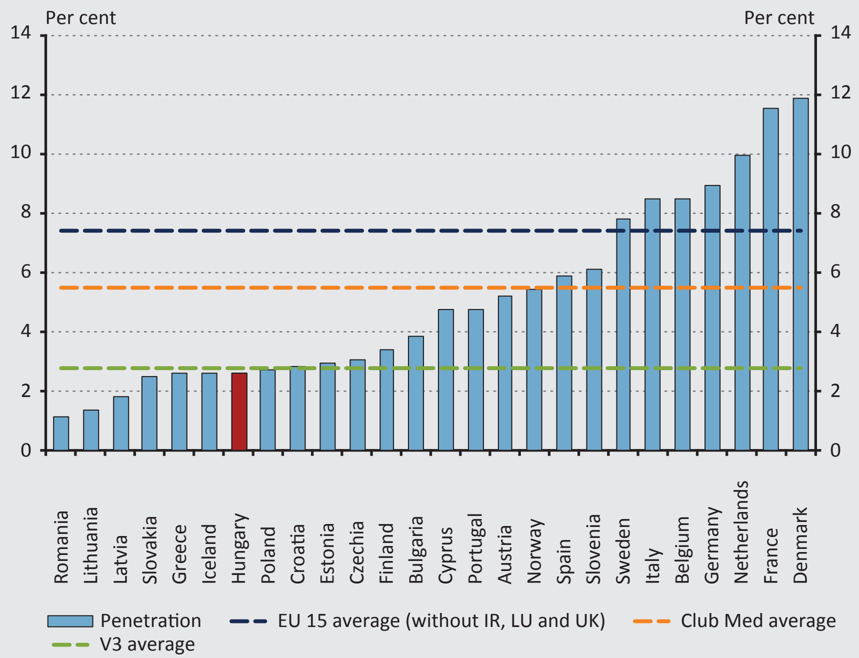
associations as a share of GDP was 2.5 per cent in 2020 (*Figure 1*). Thus, Hungary was in the bottom third of European countries, with the penetration rates in Poland (2.7 per cent) and Czechia (3.0 per cent) being higher among the countries in the region. As a result, the average penetration rate of 2.7 per cent for the other three Visegrád countries also exceeded the rate of penetration in Hungary. Other groups of countries with more advanced economies, such as the Club Med (Greece, Italy, Portugal and Spain) and the EU15, had higher values than the Visegrád countries (5.3 and 7.3 per cent).

Figure 1
Penetration in European countries in 2020



Source: EIOPA, Eurostat, HCSO, MNB

Penetration in Hungary is also low compared to countries with similar levels of economic development, which in itself indicates the potential for expansion in the insurance market. Prior to the 2008 economic crisis, the indicator had been rising steadily, reaching a historic high of 3.6 per cent in 2007. The negative impacts of the crisis decreased demand for the services of the insurance sector, forcing some customers to withdraw their savings in life insurance. The preferential repayment of foreign currency loans during 2011–2012 had a smaller impact, but also reduced savings.

To a large extent, a sustained upturn in the insurance market depends on the macroeconomic environment. On the one hand, non-life insurance, e.g. compulsory motor third party liability insurance (MTPL) or home insurance, requires the existence of an insurable asset, i.e. an increase in the wealth of society. On the other hand, the inflow of savings into the sector from the life insurance side is a source of growth, which can take place at sufficiently high income levels. Finally, as insurance is not currently a basic need of society (life insurance coverage is low), the growth in the demand for insurance can only be achieved with a slight time lag in the context of sustained economic growth.

As a result of the above, the impact of economic growth, which gradually recovered from 2010 onwards and stabilised from 2013, only became more visible in the premium income of insurers years later (from 2016). In addition, growth in the non-life segment was significantly influenced by the evolution of MTPL fees. The decline that started after 2007 was caused by a reduction in claims payments, which are the main determinant in the calculation of premiums, and the spread of the use of digital comparison sites, which increased price competition between insurers' products and pushed down premiums on products. The combined ratio[1] for the MTPL market peaked in 2013, when the product's sector-wide loss was at its highest. Insurers have started to increase premiums on their MTPL products in order to consolidate their losses and as claims payments started to rise again. Consolidation of the business at the sector level was achieved in 2016, when the premiums collected exceeded costs and claims payments again. From that point onwards, MTPL premium income has been a major driver for the non-life segment and for the insurance sector as a whole. The inclusion of the insurance tax in the premiums for this product category from 1 January 2019 also contributed to this over the last 2 years. In addition, growth in the MTPL business has been boosted by an increase of the insured vehicle portfolio, with the number of contracts increasing by almost one fifth (by 1 million contracts) at the sector level over the past 5 years.[2]

One factor behind the unfavourable changes in loss ratios in the MTPL market was the competitive, low premiums from insurers, which led some institutions to underprice due to a lack of full knowledge of the market. The detailed contract and claims database for compulsory MTPL insurance (known by the Hungarian abbreviation 'KKTA'), which was established by the MNB in 2018 and has been in operation since then, provides support to all institutions in the MTPL market to price their insurance contracts prudently. In addition, the granular data stored in the KKTA allows for deeper surveillance analyses than before for the whole market, with territorial (postal code-based) data on contracts and tortfeasors.

[1] The sum of the cost of a given product and the amount of claims payment in proportion to its earned premium.

[2] MNB (2021): *Report on Insurance, Funds, Capital Market Risks and Consumer Protection.* Magyar Nemzeti Bank. https://www.mnb.hu/letoltes/kockazati-jelentes-2021-hun-0621.pdf

A noticeable lack of information was also felt on the consumer side on the MTPL market. The MTPL index developed and published by the MNB in 2021 also allows the average customer to monitor the evolution of premium levels. In addition, by taking into account the estimated average change in damages and tax, it is able to illustrate how the average premium has changed after filtering out the change in damages and tax. The MTPL index can provide the public with a comprehensive picture of the market thanks to data from the KKTA, because it covers not only those who switch insurers, but also the contracts that remain unchanged as well as new entrants.

With the expansion of the range of consumer-friendly financial products, the MNB launched the Certified Consumer-friendly Home Insurance (CCHI) qualification in 2019. With the CCHI, the MNB aims to standardise the content and raise the quality of products in the other major non-life product group, home insurance. Following the insurance product developments in 2020 and the submission of tenders, CCHI-qualified home insurance already became available to customers in 2021. Standardised content has the potential to increase customer confidence via stronger competition and increased transparency.

Turning to life insurance again, mainly due to the importance of life insurance with savings purposes, the stabilisation of economic growth from 2013 onwards brought a return to sustained growth. This was strongly supported by the introduction of personal income tax relief for pension insurance policies taken out after 2014. Pension insurance, along with other life insurance products with a savings purpose, is one of the products for long-term self-reliance, and thus along with an appropriate economic environment, it is essential to build and maintain confidence.

To build customer confidence and avoid the mis-sellings that have occurred in the past, the MNB has worked with legislators and market players to create ethical life insurance regulation.[3] The primary objective of regulating life insurance policies that include a savings element was to increase transparency and comparability at fair value for money. The annual cost rate (ACR), which has been used by the insurance industry in the past and was determined by the MNB at the level of a regulation, has made a significant contribution to achieving the comparability of individual products on the one hand, and the ACR limits set in the MNB's unit-linked recommendation (No. 8/2016) have provided an opportunity to move towards the cost level acceptable to the MNB on the other hand.

[3] Mátyás, M.D. – Nagy, K. – Szajkó, K. – Szekeres, D. – Szegedi, M. (2016): *Etikus életbiztosítás: evolúció vagy revolúció – Az etikus életbiztosítási szabályozás előzményei, elemei, hatása, nemzetközi párhuzamok* (*Ethical life insurance: evolution or revolution – The road to ethical life insurance regulation, its elements, impact and international parallels*). Biztosítás és Kockázat (Insurance and Risk), 3(4): 12–37. https://mabisz.hu/wp-content/uploads/2018/08/biztositas-es-kockazat-3-evf-4-szam.pdf

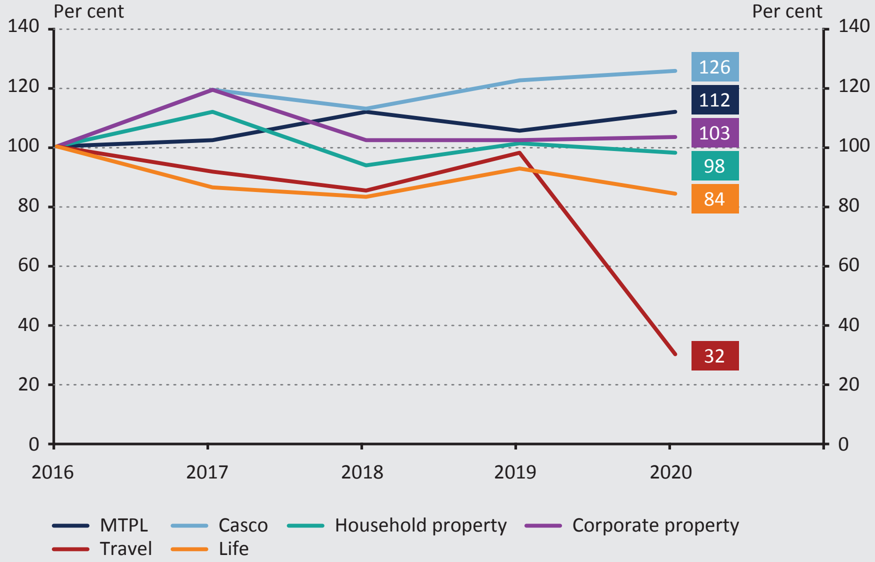
By strengthening customer confidence, ethical life insurance regulation enables the development of a stable portfolio over the long term, making the sector's operation and profitability more predictable than in the past. The regulatory framework, which became complete from 1 January 2017, has not caused a significant decline in life insurance sales, but the targets have been met or there is a shift towards them. Acquisition commission rates have been reduced in line with the new rules introduced, and thus retention (sperative) commissions have been given more emphasis, encouraging sellers to maintain the durability of their portfolio. For the products concerned, the cost levels have decreased in line with the ACR limits set in the unit-linked recommendation, and the direct and indirect costs of asset management have also fallen accordingly. The average duration of the maturity structure of net cash flows associated with unit-linked life insurance contracts has increased, with more emphasis on longer maturities, implicitly indicating the build-up of a stable, long-term contract portfolio.

3. Growth after the coronavirus pandemic

The economic measures taken to mitigate the effects of the coronavirus pandemic had a significant impact on the economic environment in the insurance sector. The average growth rate seen in previous years (2016–2019) was 9.0 per cent, slowing to 4.7 per cent in 2020 due to the adverse environment. If we look at the time series from 2019 onwards, net of the inclusion of the MTPL insurance tax, we can calculate increases of 7.8 per cent and 3.7 per cent for the same periods.

Based on the increment in the number of insurance contracts, however, in the vast majority of products' sale significant decline was not experienced in 2020. Demand for life insurance was somewhat affected by the pandemic. The increment in the number of life insurance contracts for death risk rising slightly, while the number of contracts with savings purposes fell. At the same time, the non-life insurance market continued its normal course, with the exception of one product. Only in the case of travel insurance has there been a significant drop in demand, as lockdowns and international travel restrictions led to a significant drop in demand for the product (*Figure 2*).

Figure 2
Development of the number of contracts



Note: 2016 = 100%

Source: MNB

In 2020, it was possible to prevent the decline in premiums that characterised the post-2008 economic crisis thanks to a number of factors that made a difference. The number of people in employment probably remained high among customers with insurance with a savings purpose, and thus they were still able to pay their premiums, even if the overall number of new acquisitions declined compared to the previous year. In addition, the absence of the credit crisis that characterised the previous crisis and the option of a credit moratorium also helped to prevent customers from withdrawing their accumulated long-term savings in life insurance. Following the opening of the borders, the travel insurance business started to grow again, mitigating the impact of the coronavirus pandemic, and the growth in the insurance sector that started after 2016 may continue.

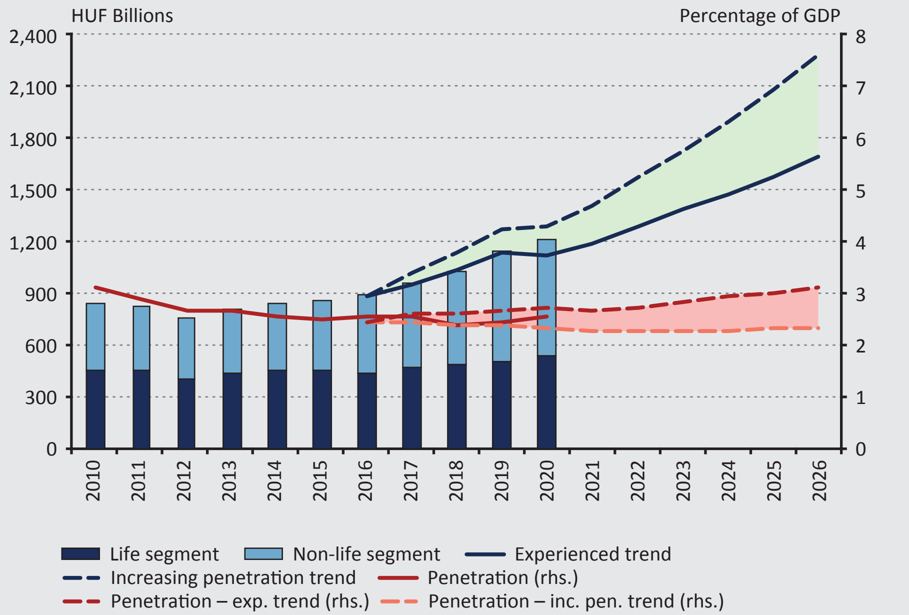
In 2018, the MNB published its paper entitled "10-year future of the insurance sector in 7 points" (hereinafter: FIS) on the future trends envisaged in the insurance sector (and partially the voluntary pension funds).[4] In this publication, the central bank set out the trends and expectations for catching up with mature markets, with a starting point of 2016. Among other things, the MNB outlined several trends for

[4] MNB (2018): *10-Year Future of Insurance Sector in 7 Points – with a Self-care Outlook.* Magyar Nemzeti Bank. https://www.mnb.hu/letoltes/pst-2018-eng-0319.pdf

the possible development of premium income, which showed the possible dynamics of the expansion of the insurance sector. Two of these have relevance in the light of the growth in recent years: the experienced trend and the increasing penetration trend (*Figure 3*).

The experienced trend suggested sectoral growth slightly below GDP growth, based on the past. The evolution of insurance premiums followed this growth path until 2019, but then diverged positively in 2020, due to the fall in GDP caused by the measures taken in response to the coronavirus pandemic. In about 5–6 years from next year, if insurance market growth approximates this trend again, the market size could be one third larger than today.

Figure 3
Gross premium income in insurance sector



Note: The experienced trend and the increasing penetration trend have been modified based on GDP and inflation data after 2016.

Source: HCSO, MNB

The increasing penetration trend sets the aforementioned 3-per cent penetration target for the sector by 2026, expecting the rise in penetration to be faster than GDP growth. For this reason, the economic downturn in 2020 brought the sector closer to reaching the target, but in the long term, steps will be needed to facilitate market expansion. The targeted penetration level would be a return to the level achieved in the past (most recently in 2010) and would move Hungary to the top of the regional ranking. This would require the insurance sector's premium income to grow by roughly an additional HUF 1,000 billion by 2026, from the current level of HUF 1,204 billion, which would exceed the penetration rate in Czechia in 2020.

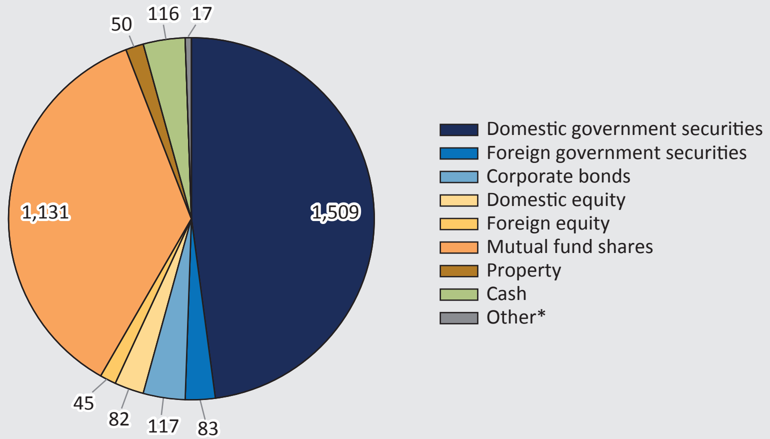
Between 2016 and 2020, growth was mainly driven by the non-life sector, and this trend may continue in the next few years if Hungary's economic convergence proceeds. This is because consumer needs have so far taken precedence over self-reliance, so that there has been demand for insurance products linked to the assets purchased (e.g. homes, vehicles, etc.). In the longer term, however, life insurance could be the main driver of market expansion as wealth needs gradually become saturated and confidence is boosted by the ethical life insurance regulation, and the need for self-reliance increases as demographics deteriorate.

4. Investments

One of the socially beneficial features of insurance investment is its ability to accumulate small amounts of regular savings from the public and convert them into substantial amounts of investable assets. As premium income strengthens in the life segment, life insurance technical reserves, which are also backed by assets that are part of the customer wealth, may increase further. If the above-mentioned factors help boost savings, significant resources can be made available to support the economy. In addition to reserves, insurers also invest their own funds (which, since the transition to Solvency II in 2016, has been above the 150 per cent capital level recommended by the MNB for the vast majority of market participants), which can thus also serve as a source of funds for the economy.

At Solvency II value, insurance assets in 2020 were HUF 3,150 billion, of which 48 per cent was invested directly in Hungarian government securities (*Figure 4*). Taking into account the underlying asset composition of investment fund shares, this ratio was 52 per cent, totalling HUF 1,650 billion, which was 5.7 per cent of Hungary's HUF-denominated debt. The significant government bonds portfolio in domestic currency is mainly part of the assets underlying the non-unit-linked portfolio.

Figure 4
Asset composition of insurers' investments (HUF billion) in 2020



*Note: The source of asset values is Solvency II reporting. * Other category: mortgages, structured products, futures, swaps, options, derivatives, loans, funds of funds.*

Source: MNB

On the one hand, insurers prefer liquid assets with a secure yield, which allow them to reliably plan their expected future cash flows, and on the other hand, the advantage of forint denomination is the elimination of foreign exchange risk (investing in the same currency as the expected payouts), for which the Solvency II regime sets a lower own capital requirement. In recent years, the only factor that was able to override these considerations was the low yield environment, but the forint yield curve has not declined to the extent that it would have been worthwhile for insurers to shift their investments into higher-yielding but riskier assets. Because of these two favourable features of Hungarian government bonds, insurers are expected to continue to be stable buyers of these instruments, providing a secure source of funding for Hungarian government debt.

An additional advantage of the insurance sector is that the maturity structure of life insurance cash flows extends beyond 20 years, which may make institutions interested in buying long-term (up to 20-year) government bonds. Currently, a total of 18 per cent of the 2041/A and 2038/A government bonds are held by insurers. As pension insurance continues to grow and life insurance retention in general improves, the institutions could also play an additional debt-financing role.

The second largest group of direct investments is investment fund shares which accounted for 36 per cent of the insurers' assets in 2020. This asset category is used almost entirely to cover the reserves of unit-linked life insurance policies. Shares account for 54 per cent of mutual fund shares, showing that clients prefer riskier forms of investment over institutions in order to have higher return potential.

The economy-supporting nature of investment fund shares is more nuanced than that of government bonds, as 63 per cent of them cover foreign-backed assets. This means that overall, one quarter of the direct and indirect investments within the insurers' assets is used to fund foreign economies, and three quarters of them supply resources to the domestic economy. However, with the convergence of Hungary's economy (including the expansion of the corporate sector), the domestic investment rate may improve, making insurers a natural ally of the Hungarian stock market and economic policy in the long run.

5. Summary

Regarding the relative size of the Hungarian insurance sector, it covers 2.5 per cent of the economy, which is low compared to countries with a similar level of development. The low penetration rate is due to the 2008 crisis and the economic difficulties that followed. However, the sector's premium income improved with the economic recovery, and the positive trend was not interrupted by the economic slowdown due to the coronavirus pandemic that unfolded in 2020, it was only slowed slightly. The portfolio of insurers has proved durable despite the adverse conditions. This was also supported by the MNB's measures, which may further strengthen customer confidence in the sector in the future. There is a good chance that the sector's revenues will grow in line with Hungary's economic performance, and that by 2026 insurance penetration will return to above the 3-per cent level seen in previous periods. Customer wealth accumulated in reserves may increase in line with life insurance premium income. A significant part of the assets invested by insurers is already part of the financing of public debt and represents a relatively large share in providing resources for financing long-term public debt. In the long run, not only can the insurance sector become a growing player in the economy, but it can also help achieve economic policy goals and finance the domestic stock market by converting small, regular savings into substantial amounts of investable assets.